REDACTED (PUBLIC) VERSION

COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

Investigation by the Department of Telecommunications and Energy on its own Motion into the Appropriate Regulatory Plan to succeed Price Cap Regulation for Verizon New England, Inc. d/b/a Verizon Massachusetts' intrastate retail telecommunications services in the Commonwealth of Massachusetts	)	**D.T.E. 01-31 Phase II Track B**

REPLY BRIEF OF THE ATTORNEY GENERAL

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REPLY BRIEF OF THE ATTORNEY GENERAL

I. SUMMARY

Verizon New England, Inc., d/b/a Verizon Massachusetts ("Verizon," "Company" or "VZ-MA"), and AT&T Communications of New England, d/b/a AT&T ("AT&T"), seek approval from the Department of Telecommunications and Energy ("Department") for Verizon to raise basic residential rates, without further review, by hundreds of millions of dollars over the next several years. Verizon makes its extraordinary request without presenting any current data showing that basic residential rates are below costs. Verizon and AT&T instead rely on stale data to claim, in an industry where costs have fallen markedly, that higher residential rates would be more economically efficient.[1] The Department should not raise basic residential rates because Verizon has not satisfied the statutory standard by showing that proposed rates would be just and reasonable, non-discriminatory, and necessary for the Company to obtain reasonable compensation for providing residential services. G.L. c 159,§20.

Market forces alone are insufficient to regulate Verizon's dominant control over the

[1] AT&T also disputed current cost data presented by the Attorney General, but made errors regarding those data. *See*, section A.2, *infra*.

residential market. Before allowing Verizon to raise residential rates, the Department should investigate why the Massachusetts universal service penetration rate, unlike most of the nation, has dropped and is the lowest in the region. Finally, the Department should strengthen Verizon's service quality plan using updated data.[2]

II. ARGUMENT

A. No Party Has Shown That Raising Residential Basic Service Rates Will Yield Rates That Are Either More Efficient Or Just And Reasonable, Non-discriminatory, and Necessary For Reasonable Compensation.

1. No party has provided reasonably current data showing that residential basic service rates are below efficient levels or yield insufficient contribution toward joint and common costs.

Verizon and AT&T argue that, although residential basic rates are not below marginal costs, and therefore are not subsidized, they are inefficient, unfair and too low because: 1) they do not contribute their fair share toward recovery of joint and common costs; 2) they are below target rates set by the Department in 1990; and 3) industry elasticity studies indicate that dial tone is the most inelastic rate element, and so, under Ramsey pricing, should be used to recover the remaining revenue requirement that would not be recovered through rates based on incremental costs. Verizon Brief, pp. 8, 9, 24-25; AT&T Brief, pp.14, 23.

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[2] The Attorney General for the Commonwealth of Massachusetts ("Attorney General") files this Reply Brief for the purpose of responding to arguments made in the initial briefs submitted by Verizon, AT&T, and WorldCom, Inc. ("WorldCom"). This reply brief is not intended to respond to every argument made or position taken by Verizon, AT&T, and WorldCom. Rather, it is intended to respond only to the extent necessary to assist the Department in its deliberations, *i.e.*, to provide further information, to correct misstatements or misinterpretations, or to provide omitted context. Therefore, silence by the Attorney General in regard to any particular argument, assertions of fact, or statement of position in the other parties' briefs should not be construed as agreement with such argument, assertion or position.

a. **Verizon's contribution analysis is based on stale data and is outdated given loop technology.**

Verizon claims that it "presented unrebutted evidence in this case demonstrating that the Residence Dial Tone rate is far below an economically efficient level because it fails, by a significant margin, to provide a comparable level of contribution toward the recovery of Verizon MA's joint and common costs as other services." Verizon Brief, p. 9. Verizon's claim is incorrect because: 1) it is based on stale data, and 2) some of the Company's own positions, current record data and the testimony of Professor David Gabel rebut the claim. Exhs. AG-1 and 2; Tr. 2, pp.179-256.

Verizon analyzed contribution toward the recovery of Verizon MA's joint and common costs by comparing current and proposed rates to its Marginal Cost Study VI, an estimate of marginal costs filed with, but not approved by, the Department as part of a transition filing in 1993. Exh. VZ-5, Attachment A, p. 1;[3] *New England Telephone and Telegraph Company*, D.P.U. 93-125, p. 14 (January 1994). Verizon's reliance on data that are nearly ten years old is misplaced in an industry that has experienced "significant changes" since 1995[4] and where overall costs have been declining. Verizon Brief, p. 6; *WorldCom, Inc. et al., v. F.C.C.*, No. 01-1198, 2002 U.S. App. LEXIS 22009 (D.C. Cir., October 22, 2002), (Slip opinion, p. 7); Exh. AG-2, p. 14. Verizon also implicitly relies on data even older than 1993. By claiming that

[3] The Company claims that present and proposed dial tone rates are too low because they are only 22 and 40.5 percent above the 1993 estimate of marginal costs, which is much lower than the percentages for other services. *Id.*

[4] Dr. William E. Taylor testified for Verizon that "[i]mplementation of the Telecommunications Act of 1996, along with changes in regulation and technology, has changed the fundamental structure of telecommunications markets in Massachusetts and throughout the United States." Exh. VZ-3, p.4.

residence dial tone should rise instead of advocating the reduction of rates showing higher contribution percentages, Verizon implicitly assumes that it is still entitled to recover a level of joint and common costs as part of a revenue requirement that the Department last reviewed in the 1980's. *New England Telephone and Telegraph Company*, D.P.U. 86-33-G (1989). The Department should not permit Verizon, in this declining cost industry, without evidence of current revenue requirement or even earnings, to base its pricing on outdated data.

Verizon's contribution analysis and claims of unfairly low dial tone contribution are also outdated and unreliable given new loop technology and customer demands for joint voice and data services. Verizon continues to argue that it must recover all loop costs in dial tone rates and that "the loop or dial tone service cannot be a joint or shared cost." Verizon Brief, p. 28. Verizon ignores the fact that, under current technology, many loops can be used for data as well as voice. Verizon's stance here is directly contrary to the position the Company took recently in federal court[5] and the position its witness, Dr. Taylor, took in a New Mexico proceeding. Exh. VZ-7. Dr. Taylor testified there that the cost of the loop "is a shared fixed cost" between voice access to the network and high frequency data, and that "in a competitive market those costs would be recovered, the cost of the loop would be recovered from voice services in part and from data services in part." Exh. VZ-7, pp. 19-21. AT&T underlines the importance of the new loop technology, arguing that the availability of "fiber-fed loops to provide bundled voice and data services–services that an increasing portion of the residential market is now demanding" is critical for competition in the residential market. AT&T Brief, p. 28. The Department has

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[5] The Company argued that it is a violation of Federal Communications Commission ("F.C.C.") rules to recover none of the loop costs from data services. *USTA v. F.C.C. and Bell Atlantic, et al.*, 290 F. 3d 415 (D.C. Cir., May 24, 2002).

determined that such equipment is engineered based upon busy hour usage, which is traffic sensitive. Tr. 2, p. 223. Recovering loop costs only from flat end-user dial tone rates, as though the loop remained entirely non-traffic sensitive, would no longer provide the correct economic signals to end-users, competitors, and investors. Exh. AG-1, p. 11.

Dr. Taylor also testified that "when you have truly joint products, you can't say anything about the individual incremental costs of the services." Exh. VZ-7, p. 90. Because loops now provide, and will increasingly provide, joint voice and data services, the incremental cost of the loop should be zero. Tr. 2, pp. 255-256. Verizon's contribution analysis, which treats joint loop costs as though they are incremental costs of dial tone, is outdated and unreliable.

b. 1990 Department findings based on 1980's data provide no basis for raising dial tone rates more than 12 years later.

Verizon and AT&T argue that the Company should be authorized to raise residential dial tone rates, consistent with findings the Department made more than 12 years ago. Verizon Brief, p.10; AT&T Brief, p.12. For example, AT&T argues that dial tone rates are inefficiently low because they are below the $15.00 target rate set in 1990.[6] AT&T Brief, p.12, 14-15.

The Company arrived at the $15.00 target by assuming that residence dial tone was the least elastic rate element, and using residual pricing (a method the Department did not endorse) to recover a revenue requirement based on 1986 data. *New England Telephone and Telegraph Company*, D.P.U. 89-300, pp. 79-80, 82 (1990). The carriers and the Department should not rely on outdated findings based on such stale data to set current rates. Changes in telecommunications and the declining cost nature of the industry render such outdated findings

[6] AT&T even suggests that the Department should increase the $15 dial tone target for inflation, bringing it to $18.11. AT&T Brief, p. 14.

irrelevant for setting rates today.

c. Industry elasticity studies from the 1970's to 1990 are insufficient evidence to conclude now that dial tone is the most inelastic rate element.

Verizon and AT&T contend that residential dial tone rate is far below an economically efficient level because it is the most inelastic rate element and, under Ramsey pricing, should be used to recover any revenue requirement not recovered through rates based on marginal costs. Verizon Brief, p. 25; AT&T Brief, p. 23. Verizon cannot even identify the economically efficient level of rates. Exh. DTE-VZ 4-1.

There are two fatal flaws in the carriers' argument. First, elasticity studies published from the 1970's to 1990 do not prove what is the most inelastic rate element today, in light of the major changes since 1990, including increasing telephone access options in wireless and cable.[7] Even if the Department does consider the stale elasticity data, those data do not support a conclusion that intraLATA toll is more elastic than access. The long run elasticity presented by Verizon for access (.27) is only slightly lower than Verizon's estimate of the elasticity for intraLATA toll (.3). Tr. 2, p. 220. Since the old data were collected, the Department has implemented a major rate rebalancing in D.P.U. 89-300 and succeeding cases, raising residential dial tone rates and local calling rates substantially and reducing intraLATA toll rates. These rate

[7] AT&T argues that there is no loss in public welfare if customers are forced, because of higher prices, to switch from wireline telephone to wireless or cable. AT&T Brief, pp. 22-23. Wireless and wireline telephony are in different markets and provide different, albeit similar products. The quality of service on wireless networks is inferior to wireline. People may switch to wireless, despite the inferior service, because the price of wireline becomes comparatively high. Furthermore, cable telephony doesn't have the same security or back-up power that is available through traditional wireline service. AT&T is incorrect, therefore; there can be a welfare loss if customers are forced by higher prices to switch to wireline or cable.

changes would tend to lower toll elasticities and raise access elasticities. Tr. 2, pp. 220-221. The record evidence, therefore, does not clearly establish which is the least elastic rate element. Exh. AG-1, p.14.

Second, Verizon has not presented evidence to establish its revenue requirement since the 1980's or any earnings data since 1994. The record does not show the difference today, if any, between the Company's revenue requirement and revenues generated from rates based on incremental costs. On this record, the Department cannot even determine whether that difference is positive or negative, and whether to lower or raise rates. The Department, therefore, cannot conclude that higher dial tone rates are necessary for Verizon to obtain reasonable compensation and would not cause Verizon to earn an exorbitant return.

Finally, Verizon's witness Taylor concurred with the Attorney General that the cost of the loop should be classified as a shared cost when the facility is used to provide data and voice services. Exh. VZ-7, pp. 19-21, 90. As a shared cost, the incremental cost of dial tone is zero. *Id.*, p. 90; Exh. AG-1, pp. 10, 28-29. Both AT&T and Verizon have failed to take this into account and consequently they have understated the mark-up for dial-tone.

2. Proper analysis of current TELRIC costs shows that residential basic service rates exceed their costs, notwithstanding AT&T's flawed criticisms.

The Attorney General presented the only record evidence of current costs, publicly-available data from the F.C.C. showing that residential service rates are not below their current costs. Exh. AG-1, pp. 6-7, 14-15.[8] AT&T criticizes the Attorney General's evidence, arguing

[8] The monthly flat rate of $25.63 (including the F.C.C. increase to the subscriber line charge scheduled for July 2003 but excluding increases proposed in this case) exceeds the total element long run (continued...)

that his switch usage cost estimates are imprecise and he grossly understated retailing costs. AT&T Brief, pp. 10, 12. AT&T concludes that if the Attorney General corrected his analysis, it would show that residential service rates are below their current TELRIC based incremental costs, which would be at least $26.72. AT&T Brief, p. 12.[9]

AT&T's criticisms are flawed. AT&T included costs twice that should not be included even once and ignored the record evidence. AT&T claims that the TELRIC cost of switch usage is $4.63 per month, the upper range of values identified in Professor Gabel's direct testimony. Exh. AG-1, p. 8; AT&T Brief, p. 12. After that direct testimony was filed, however, Verizon provided the cost of the UNEs that would be required for basic residential service, reporting that the monthly cost for unlimited usage was **<<PROPRIETARY** >>, not $4.63 per month. Exh. DTE-VZ-3-1. Verizon's number is based on Massachusetts usage data that Professor Gabel did not have for his study, and should be substituted for the conservative $3.30 - $4.63 range he incorporated for switch usage costs.[10]

Although AT&T's witness testified that joint and common costs are excluded from the estimate of the incremental cost of service, Exh. AT&T-1, pp. 25-26, the TELRIC cost estimates

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[8](...continued)
incremental costs ("TELRICs") of the unbundled network elements ("UNEs") that provide dial tone and local usage (loop $14.98, switch port $2.00, switch usage $3.30-$4.63 and retailing costs (customer service and marketing) $1.73). Professor Gabel summed those TELRIC costs at $22.01- $23.34 in his initial testimony. Exh. AG-1, pp. 8, 11-12.

[9] AT&T reached its total using the same cost figures as Professor Gabel for loop ($14.98) and switch port ($2.00), but substituted higher numbers for switch usage ($4.63) and retailing costs ($5.11). *Id*.

[10] AT&T criticizes Professor Gabel for relying on Vermont usage data, rather than Massachusetts data, and then chooses to rely on Vermont data in its cost calculations rather than the Massachusetts data that are part of the record. *See* AT&T Brief, p. 12, n. 6.

in fact include a mark-up of approximately 25% for joint and common costs.[11] The joint and common costs should be removed, reducing the monthly cost of loop, switch port and switch usage from <<**PROPRIETARY** >>.

AT&T's profitability analysis has additional serious shortcomings. Despite its argument that joint and common costs should be excluded from the incremental cost of service, AT&T again added in such costs when it proposed that the avoided cost discount be used to estimate retailing costs, yielding $5.11 rather than the $1.73 used by Professor Gabel. AT&T Brief, pp. 11-12; Exh. AG-1, pp.8, 40; Tr. 2, pp. 188-189. The 29.47% avoided cost discount includes the avoided costs associated with joint and common costs.[12] Since the avoided cost discount includes both direct and joint costs, the cost of retail service should be estimated directly, rather than calculated using the cost proxy proposed by AT&T. The Department has previously pointed out that the avoided cost discount was never designed to determine the incremental cost of service. In the decision cited by AT&T, the Department noted that "We are trying to create a hypothetical wholesale telecommunications company and determine what its rates would be to resellers if it were run efficiently. In reaching this determination, we are not attempting to conduct a bottoms-up incremental cost study for resale of local exchange service." *Id.* at 12.

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[11] Verizon's response to Exh. DTE-VZ-3-1 starts with the tariff rates. The rates have not been reduced to reflect joint and common costs. Exh. VZ-5, Atta. B, columns (e) and (g). AT&T has used the TELRIC price of $2.00, for example, as an estimate of the incremental cost of the port, rather than the TELRIC price, less the joint and common costs.

[12] *Consolidated Petitions of New England Telephone and Telegraph Company d/b/a Bell Atlantic-Massachusetts, Teleport Communications Group, Inc., Brooks Fiber Communications of Massachusetts, Inc., AT&T Communications of New England, Inc., MCI Telecommunications Company, and Sprint Communications Company, L.P., pursuant to Section 252(b) of the Telecommunications Act of 1996, for arbitration of interconnection agreements between Bell Atlantic-Massachusetts and the aforementioned companies*, D.P.U./D.T.E. 96-73/74, 96-75, 96-80/81, 96-83, 96-94 – Phase 2 Order (December 3, 1996), pp. 7-9, 23.

AT&T has attempted to use the avoided cost value for a purpose for which the Department has stated it is ill suited—determining the incremental cost of service.

AT&T's residential profitability analysis also ignores the rates and costs associated with Suburban and Metropolitan services ($24.98 and $30.60 respectively). The TELRIC cost of usage for these products are **<<PROPRIETARY** >> for Suburban service and **<<PROPRIETARY** >> for Metropolitan service, Exh. DTE-VZ 3-1, so the profits on these residential usage services are more than **<<PROPRIETARY** >> higher than the profits earned from basic flat rate usage service. *See* Table 2 (proprietary). AT&T ignores the large margins being earned from Suburban and Metropolitan calling when it avers that "the TELRIC based incremental cost of providing exchange service…exceeds even the higher residential rate proposed by Verizon of $25.63." AT&T Brief, p. 12.

It is not possible to correct all of the errors in the flawed methodology AT&T used to calculate retail costs. Correcting AT&T's flawed estimates by removing the mark-ups for joint and common costs: 1) 25 percent for loop, switch port and switch usage, Exh. VZ-5, Atta. B, columns (e) and (g); and 2) 29.47 percent for retailing costs (from $5.11 to $1.73, AT&T Brief, p. 12), yields the profit earned on flat rate residential service today: $25.63 revenue[13] minus costs **<<PROPRIETARY** >> equals profit **<<PROPRIETARY** >>. Furthermore, the total margins earned from residential Suburban and Metropolitan subscribers are more than **<<PROPRIETARY** >> higher than for

[13] This figure presumes that the Department allows Verizon to increase the dial tone rate by the $2.44 proposed by the Company, rather than the possible $7 increase identified in the Attorney General's Initial Brief, p. 2.

flat rate residential service. Excluding AT&T's errors, the proper TELRIC analysis shows that residence rates far exceed their costs.

3. The proposals to raise residential rates by five or ten percent per year could cost customers $32 million to $242 million annually and hundreds of millions to over one billion dollars cumulatively over six years.

Verizon portrays its request for permission to raise rates five percent each year without Department review as a "modest," "small," "reasonable," and "very limited" rate increase. Verizon Brief, pp. 2, 7, 8, 10. The Company does not mention that this "modest" increase could raise Verizon's revenues, and cost its residential basic service customers, more than $31 million each year and cumulatively almost $400 million if it implements five percent increases for the next six years.[14] Exh. VZ-2, Attachment A, Tab B (revised 08-28-02), Attachment I, Workpaper 1; AT&T Brief, pp. 17, 21; Appendix, Table 1. If Verizon implements ten percent increases for the next six years, as AT&T proposes, it could cost residence basic service customers more than $78 million each year and cumulatively more than $1 billion. AT&T Brief, pp. 17, 21; Exh. ATT-1, p. 19; Appendix, Table 1.

Such revenue shifts from customers to Verizon are not "*de minimis*," and are not so regarded by Verizon. The Company, for example, seeks permission to change prices where

[14] Verizon proposes to increase its dial tone rate immediately by $2.44 to reflect changes in the intrastate switched access prices and other Department-ordered adjustments. Verizon also seeks authority to raise basic residential rates (including residential dial tone, residential measured usage charges, and the usage associated with Unlimited usage, Metropolitan usage, Suburban usage, Circle usage, and Expanded Community Calling service) without Department review by up to five percent each year for the indefinite future. Verizon Brief, pp. 4-6; Exh. VZ-2, p. 6. Five percent increases for the next six years, following a $2.44 increase as Verizon proposes, would cost ratepayers cumulatively an extra $391 million. Appendix, Table 1.

events beyond the control of the firm ("exogenous events") have a revenue impact of only $3 million. Verizon Brief, p. 4, n. 2; Exh. VZ-1, Tab A, p. 4.

B. Market Forces Are Not Sufficient To Control Verizon Or Establish Efficient Residential Prices.

There is some limited competition to Verizon in the residential local and toll markets, and the industry and the markets are evolving. Verizon is incorrect, however, in asserting that the residential market is competitive enough to merit limited pricing flexibility and the elimination of the service quality plan. Competitors in the local and toll residential market do not control enough market share to exert effective pressure on Verizon to keep the Company's rates low and service quality high.

1. Competitors control less than 15% of the local markets.

Verizon refers to the Massachusetts residential market as a "competitive" market, Verizon Brief, p. 3,[15] but fails to note that competitors control only a very small amount of the residential local market. Competitors' market share, including business as well as residential services, is fifteen percent based on public data Verizon submitted to the F.C.C., meaning Verizon still controls over 85 percent of the market. Exh. DTE-AG 1-1 (Attachment). Other Verizon data show that competitors' market share of residential services is only **<<PROPRIETARY** >> as of August 2002. Exh. AG-VZ 4-2A (proprietary). AT&T characterized the level of competition in the residential market as "anemic." AT&T Brief, p. 14.

[15] The Company suggests that the residential market is competitive because the competitive local exchange company ("CLEC") supply elasticity is high. Verizon Brief, p. 7, n. 6. The record does not contain the CLEC supply elasticities, so the Department should not reach unsubstantiated conclusions regarding this claim.

Verizon did not seek pricing flexibility for residential services in Phase I, and the Department has not found that there is sufficient competition.

2. The Department should require Verizon to behave in ways that maintain the current level of competition.

The Department should require Verizon to behave in ways that foster UNE-P competition for residential services in the local and intrastate toll markets. *See,* WorldCom Brief, pp. 3-4; AT&T Brief, pp. 23-29. The Department and the F.C.C. relied on the level of UNE-P competition in supporting Verizon's bid for Section 271 interLATA authority. *In re Application of Verizon New England Inc., [F]or Authorization to Provide In-Region, InterLATA Services in Massachusetts*, CC Docket No. 01-09, Memorandum Opinion and Order, FCC 01-130 (April 16, 2001), ("FCC Order") p. 3.[16] Verizon used the number of UNE-P competitive access lines as part of its pricing flexibility petition for business services (D.T.E. Phase I, Exh. VZ-1, pp. 10-11 (Testimony of Robert Mudge). Verizon goes so far as to say: *"In light of existing competition throughout Massachusetts* ... Verizon's MA's Plan effectively constrains its ability to raise prices for any retail residential service above the competitive market level." Verizon Brief, p. 16 (emphasis added).

The Department should take the suggestion by the competitive local exchange carriers ("CLECs") (which refers only to UNE platform competition) one step further to include resale competition. While resold services may not allow a competitor to differentiate its product as

[16] "Verizon also states that it provides ... more than 23,000 unbundled loops provided as part of an unbundled network element platform (UNE-P). There is also an active resale market in Massachusetts. Verizon states that it provides more than 268,000 resold local exchange lines, including 238,000 business lines and 30,000 residential lines. These results bear out the fact that Verizon has made extensive efforts to open its local markets in compliance with the requirements of the [Telecommunications] Act." *FCC Order,* p. 3. "As of December 2000, approximately 35 percent of the total UNE-Ps in Massachusetts were used for residential services." *Id.*, p. 22, n. 112.

much from the Verizon product as does UNE-P, resellers do provide a Verizon alternative, just like UNE-P, if the consumer becomes dissatisfied with the Company. Furthermore, the FCC relied on competitive resale as part of its Section 271 approval, and resold competitive lines outnumbered UNE-P competitive lines. (FCC Order, *supra*). The record evidence from Phase I [17] showed that in November/December 2001, of the total number of competitive residential access lines, <<**PROPRIETARY** >>, <<**PROPRIETARY** >> came from resale, whereas far fewer, <<**PROPRIETARY** >>, came from UNE-P. Exh. AG-3A [D.T.E. 01-31 Phase I, DTE-VZ RR 2A (proprietary)].[18] This is most likely due, in large part, to the current high resale discount rates.[19] The Department should maximize the consumers' options for service by requiring Verizon to behave in ways that foster resale and UNE-P competition for residential services in the local and intrastate toll markets.

3. Effective competition for residential services would require large increases in competitors' market shares.

In Phase I, the Department granted Verizon full pricing flexibility for most business services upon a showing that competitors had greatly increased their statewide average market share to **<<PROPRIETARY >>** percent and that Verizon's market share, on average, had fallen to **<<PROPRIETARY >>** percent statewide. D.T.E. 01-31 (Phase I), DTE-VZ RR-2A

[17] Verizon refused to provide the updated breakdown for resale and UNE-P competition in Phase II, contending that this information would be provided in February 2003 to the Department. Tr. 2, pp. 129-131. The Department denied the Attorney General's record request for this updated information, which would not be available until after the Phase II briefing period concluded. *Id.*, pp. 133-135.

[18] *See also* D.T.E. 01-31 (Phase I), Exh. VZ-1 (April 12, 2001 Testimony of Robert Mudge) – "As of January 2001, the 54 resellers currently offering services in Massachusetts provided almost 237,000 business lines and 32,000 residence lines. ... As of January 2001, there were over 85,000 total UNE loops (the facility from the customer's premise to the CLEC collocation site) in service in 191 Verizon MA central offices. CLECs are also providing 27,000 lines throughout the state using UNE-P." *Id.*, pp. 8, 10-11.

[19] Verizon's discount rates are 24.99% if the reseller uses Verizon's operators and 29.47% if the reseller does not use Verizon's operators. Exh. AG-VZ 5-7.

(proprietary). Competitors would have to increase their statewide residential market share **<<PROPRIETARY** >> before they reach the competitive market share level that existed in business markets when the Department found sufficient competition. Exh. AG-VZ 4-2A (proprietary). The Department should not award Verizon full pricing flexibility for residential services until effective competition is established and maintained.

C. Before Raising Residential Rates, The Department Should Determine Why Massachusetts' Household Penetration Rate Has Dropped Relative To Other States After Rates Were Increased In 1990-1994.

Verizon asserts on brief that its proposed rate increases will not affect the universal service penetration rate. Verizon Brief, p. 16. The data undermine Verizon's assertion. Exh. AG-2, pp. 12-13. Before allowing Verizon to raise its basic residential rates and, perhaps, inadvertently reduce the universal service subscriber penetration rate even further, the Department should examine and determine the root cause(s) for low subscribership and why the Massachusetts penetration rate has declined where nearly all other states have experienced an increase in penetration.

D. Verizon Must Strengthen Its Outdated Service Quality Plan By Using Current Data.

1. Competitors do not control enough of the market to keep Verizon in check on service quality.

The Company claims that "based on the existing level of competition for telecommunications services in Massachusetts, there is no longer need for the Department to impose retail service standards and penalties on any carrier, including Verizon MA." Verizon Brief, p. 20. With Verizon controlling at least 85 percent of the intrastate local and toll phone markets, however, the Department cannot reasonably rely on market forces alone to correct the

Company's incentive to raise prices or cut service quality where effective competition does not exist. Exhs. DTE-AG 1-1, 1-2.

2. The service quality plan created in DPU 94-50 is insufficient to meet current needs.

Verizon, the dominant telecom provider in the Commonwealth, urges the Department to eliminate service quality measurements as "unnecessary" or, if required, to keep the existing standards and thresholds. Verizon Brief, p. 19-20. In doing so, the Company is asking the Department to treat its customers to outdated service quality standards that do not reflect improving technologies and merger savings. The Company completely ignores and attempts to downplay its dominant carrier status in the intrastate markets and its ability to set the service quality standards for all Massachusetts consumers. The Company is also encouraging the Department, indirectly, to hold Verizon to a lower retail performance standard than electric or natural gas distribution companies, without justifying that lower performance standard. *Investigation by the Department of Telecommunications and Energy on its Own Motion To Establish Guidelines For Service Quality Standards For Electric Distribution Companies and Local Gas Distribution Companies, Pursuant to G.L. c. 164, § 1E*, D.T.E. 99-84, Order, pp. 12-13 (June 29, 2001). The Department should not lower those standards but should, instead, update and strengthen Verizon's service quality plan using current data.

III. CONCLUSION

For these reasons, the Department should: 1) reject proposed dial tone increases; 2) deny Verizon's request for authority to raise rates without further Departmental review; 3) freeze residential rates; 4) order Verizon to undergo an independent audit of its regulatory accounting;

5) order Verizon to file all data needed to establish the Company's revenue requirement, or at least to show that its current earnings are not excessive; 6) order Verizon to file cost of service studies to establish the current costs to serve residential customers; 7) investigate why Massachusetts penetration has dropped relative to other states after rates were increased in 1990-1994; and 8) reject Verizon's current service quality plan and investigate setting rising standards and thresholds.

Respectfully submitted,

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APPENDIX – TABLE 1 – Rate Increase Impacts

APPENDIX – TABLE 2 (Proprietary) – AT&T estimates - margin on usage

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DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

Investigation by the Department of Telecommunications and Energy on its own Motion into the Appropriate Regulatory Plan to succeed Price Cap Regulation for Verizon New England, Inc. d/b/a Verizon Massachusetts' intrastate retail telecommunications services in the Commonwealth of Massachusetts	))))))	**D.T.E. 01-31 Phase II Track B**

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the official service list compiled by the Secretary in this proceeding by e-mail and either hand-delivery or U.S. mail.

Dated at Boston this 3rd day of December 2002.

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